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C O N F I D E N T I A L SECTION 01 OF 02 BAGHDAD 002990

SIPDIS

E.O. 12958: DECL: 07/19/2025

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SUBJECT: DEPUTY SECRETARY DISCUSSES INFRASTRUCTURE SECURITY
AND ECONOMIC/FINANCIAL ISSUES WITH DPM CHALABI

Classified By: Charge d' Affaires David M. Satterfield for reasons 1.4
(b) and (d)

1. (C) SUMMARY. Iraqi Deputy Prime Minister Ahmed Chalabi told the Deputy Secretary on July 12 that Iraq has exported for the first time in recent months oil from the Northern pipeline to Turkey. He expects a sustainable increase to 240,000 b/d in the northern oil fields. An electric power crisis appears increasingly unlikely this summer, with power generation above 5,000 MW and nearing 6,000 MW by August. Chalabi admitted, though, that these gains in the oil and electric power sectors remain overshadowed by the insanity of Iraq's current pricing and subsidy policies. He acknowledged that corruption in the Iraqi government's financial and contracting practices was a major problem. END SUMMARY.

2. (SBU) Deputy Secretary Zoellick met on July 12 with Deputy Prime Minister Ahmed Chalabi. A separate cable reports Chalabi's comments on political issues.

3. (SBU) Participants:

For the U.S. Government:

Deputy Secretary Zoellick

D Executive Assistant Ambassador Ross Wilson,

S/I Deputy Director Robert Deutsch

Adam Ereli, PA

NSC Senior Director Meghan O'Sullivan

Charge d'Affaires David Satterfield

Economic Minister-Counselor Anne Derse

Econoff (notetaker)

For Iraq:

Deputy Prime Minister Ahmed Chalabi

Good News, Bad News Stories on Energy

4. (C) Chalabi announced that Iraq had exported 4 million barrels of crude--3 million from the south plus 1 million from the north--on July 10, and that for two weeks there had been no significant attacks on Iraq's oil infrastructure. He said this was in large part because he had persuaded General Casey that exporting oil from the northern pipeline was a "major security issue," as important as re-taking Fallujah. The Deputy Prime Minister said he expected a sustained increase in production and exports from the northern fields of about 240,000 b/d, and noted that maintaining this level for four days would repay in full the \$35 million set aside for three months of security enhancements along the northern oil pipeline. Chalabi attributed the increased output to the effective performance of the 4th Division of the Iraqi National Army, working with the 42nd US division and air surveillance, which has been deployed to protect oil facilities. Looking ahead to the longer run, he expressed the hope that repairs to the 14-inch Bayji-West and other pipelines will make it possible to boost northern output to 500,000 b/d.

5. (C) Turning to oil production in the southern fields, Chalabi noted that the issue there was theft, not sabotage. The ITG had discovered seven taps into the export lines in the South. The National Energy Council would address this, he said.

6. (C) On electricity, the DPM said he believed Iraq can avoid a crisis this summer. Electric power production is nearing the record level of 5,200 MW reached in mid-2002, and load-sharing is bearable for most Iraqis, with a pattern of three hours on/three hours off. Noting that Iraq has an installed capacity for producing 8,100 MW of electric power, Chalabi expressed the hope that output will exceed 6,000 MW by August.

7. (C) Chalabi admitted, though, that these gains in the oil and electric power sectors remain overshadowed by the insanity of Iraq's current pricing and subsidy policies. Refined fuel products are sold for \$.015 a liter, and diesel is imported at the price of \$.50 a liter to generate electricity that is effectively given away for free. The DPM estimated that removing electricity subsidies could save \$1 billion over the rest of this year.

8. (C) Looking ahead, Chalabi said the best short-term fix for electric power in Iraq would be imports from neighboring states. They can sell power for \$.06/kwh, which is about

half the cost of power generation in Iraq. Over the longer-term, the solution will involve harnessing domestic hydro-power resources, such as at the site of the proposed Bekhmaa dam, as well as generating thermal power from the natural gas that currently is flared.

Corruption in Contracting

19. (C) In response to the Deputy Secretary's query about how the government is functioning, Chalabi noted that financing and contracting--and by implication corruption--represented a key issue. He said that contracting practices under the CPA and the IIG were terrible because no one followed the law or regulations. Valuable contracts were paid in advance with no performance guarantees or bonds. Goods were signed for as delivered when they were not; when they were delivered, they were not accounted for. Chalabi said the ITG's Contracting Committee (which he chairs) has made a decision to cut Iraqi middlemen out of the food distribution system and deal only with major international companies for food procurement, especially those from the US, and Australia. Iraq has just purchased 300 million tons of wheat from the US.

10. (C) Electricity Ministry contracts were not properly managed, he said, in a veiled reference to allegations of corruption against the former Electricity Minister. The Ministry of Defense was the "worst offender" with \$ 100 million in contracts unaccounted for. The Contracting Committee had therefore decided that no ministries other than the Ministry of Finance may hold bank accounts; ITG obligations over 300 million Iraqi dinars must be paid by L/C, certified check, or bank transfer. Although Iraq welcomes foreign banks, they have been slow to come. Chalabi discounted foreign banks' presence as an engine for restructuring the moribund Iraqi banking sector, another major disaster.

11. (U) REO HILLAH, REO BASRAH, REO MOSUL, REO KIRKUK minimize considered.
Satterfield